



**ETHICAL ISSUES IN
ORGANIZATION/TRANSACTION PRACTICE**

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Overview:



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Today's topics

- Review of basics:
 - Representing organizations
 - Conflicts in mergers and acquisitions practice
 - Waivers
- Current “hot button” issues:
 - Joint representation
 - Negotiation ethics
 - Clients who get too close to the line
 - Inadvertent disclosure and metadata
 - “No contact” rule: Really?

Today's topics

Identifying The Client

- Transactional practice generally involves representing “organizations”
- Organizations have multiple “constituents”
 - Owners
 - Boards of Directors (or equivalent)
 - Managers
 - Employees
- Lawyers identify with people rather than abstract entities

Today's topics

Organization as Client: Rule 1.13:

- Client is the organization “acting through its duly authorized constituents”
- Lawyer owes fiduciary obligations of loyalty and confidentiality to organization, not constituents
- “...unless the specific circumstances show otherwise” (ABA Formal Opinion 91-631)
- Duty to advise constituent whose interests are adverse to organization that you do not represent that individual and that person should consider separate counsel
- Duty to report up the ladder if a constituent is likely to cause substantial injury to the organization

Specific Conflicts

Conflicts in Mergers / Acquisitions other Fundamental Changes:

- Deal is adverse to another client / affiliate of another client
- Dispute between company and constituent (individually represented in other matters)
- Dispute between jointly represented clients
- Deal parties want one lawyer to represent both sides
- New parties become involved in ongoing deal
- “Thrust upon” conflict (e.g. adverse party is acquired by current client)
- Lawyer has “other interest” in transaction
- Acquiring company wants to engage seller's counsel after the closing
- Lawyer (or firm) learns confidential information from one client that is material to another client, but cannot be disclosed

Hypothetical 1:

Concurrent Conflict



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Facts

- You are approached by your former college roommate, Cheryl.
- Cheryl asks for your firm's help setting up an LLC for her and her partner, Jim.
- You agree and are retained pursuant to an engagement letter with the LLC.
- The LLC experiences problems with certain investments and angel investors.
- Cheryl approaches you about setting up a new fund for just her.

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Concurrent Conflicts of Interest

- The ABA model rules generally prohibit an attorney from representing a client if the representation involves a concurrent (simultaneous) conflict of interest, which occurs when an attorney represents two clients whose interests are adverse.
- ABA Model Rule 1.7(a).



When is there a Conflict of Interest?

- A concurrent conflict of interest exists when:
 - Representation of one client would be **directly adverse** to another client, OR
 - There is a significant risk that the representation of one client would be materially limited by the lawyer's responsibility to:
 - Another client of the firm
 - A former client of the firm
 - A third party
 - The lawyer's personal interest
- ABA Model Rules 1.7(a), 1.9; Circular 230 § 10.29(a).

Identifying and Resolving a Concurrent Conflict

Direct Adversity

- Direct Adversity May Exist:
 - Even if the work for the affected clients is completely unrelated
 - Even if someone else in the firm represents the other client (Rule 1.10 imputed conflict)
 - Even if the “adverse” matter involves friendly negotiations
 - Even if there is no direct contact between the clients (giving an opinion)

Identifying and Resolving a Concurrent Conflict

Key Issues for Resolving Conflicts of Interest:

- Clearly identify the client or clients
- Determine whether a conflict of interest exists
 - If direct adversity exists:
 - Decide whether the representation may be undertaken despite the existence of a conflict
 - the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
 - the representation is not prohibited by law;
 - the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal;
 - If so, consult with affected clients and obtain their informed consent, confirmed in writing
- ABA Model Rule 1.7, Comment 2.

Confidentiality in Representations of Multiple Clients

Rule 1.6

- An attorney must preserve a client's confidences and secrets from disclosure. ABA Model Rule 1.6.
- However, there is no privilege or secrecy among jointly represented clients.
- An attorney may not follow a client's instruction to keep information from another client and doing so may result in termination of the joint representation. ABA Model Rule 1.7, Comment 30.

Waiving a Conflict of Interest

Rule 1.7

- A conflict can be waived if:
 - The attorney reasonably believes that he or she will be able to provide competent and diligent representation;
 - The representation is not prohibited by law; and
 - Each client waives the conflict of interest and gives informed consent, confirmed in writing, no later than 30 days after the informed consent.
 - Copies of the written consent must be retained by practitioners for at least 36 months from the date of the conclusion of the representation.
- ABA Model Rule 1.7(b); Circular 230 § 10.29(b)

What is Informed Consent?

Rule 1.7, Comment

- Informed consent requires that each affected client be aware of:
 - The relevant circumstances;
 - The material and reasonably foreseeable ways that the conflict could have adverse effects on loyalty, confidentiality, and the attorney-client privilege; and
 - The advantages and risks involved.
- ABA Rule 1.7, Comment 18.

Consent to Future Conflicts

Effective Waivers

- The effectiveness of a waiver may depend on the extent to which the client reasonably understands the material risks.
- The more comprehensive the explanation of the types of foreseeable adverse consequences of those representations, the greater the likelihood the client will have the requisite understanding.
- Waivers that are procured from parties represented by independent counsel are most likely to be upheld.

Sample Engagement Letter Language

- If one of you should, at some time in the future, elect to advocate or pursue a position or term with respect to the Matter in a manner adverse to a position or term being advocated or sought by the other clients, then: [CHOOSE FROM THE FOLLOWING]

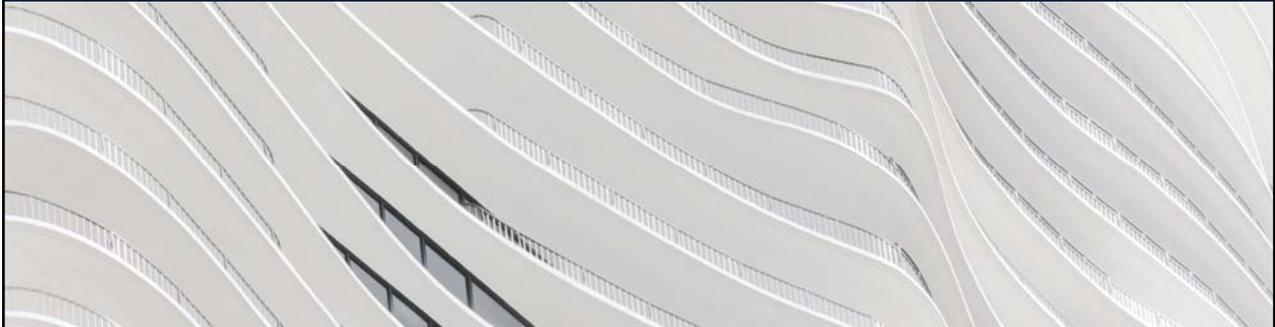
- The Firm will withdraw from any and all further representation and each of you will be required to proceed with counsel other than the Firm with respect to the Matter.

Sample Engagement Letter Language

- The Firm will withdraw from all further representation of one of the clients with respect to the Matter, and that client will then have to proceed with counsel other than the Firm with respect to the Matter. You have also consented and agreed that, under such circumstances, the Firm may continue to represent the other with respect to all aspects of the Matter.

Hypothetical 2:

Hidden Tax Problem



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Facts

- You represent a private equity fund in connection with its acquisition of a portfolio company.
- You learn that the portfolio company ignored your firm's tax advice and took a more aggressive position in its tax filings, which you know to be legally unsupported.
- Buyer wants the following common tax rep:
 - "All required tax returns have been filed and all such returns were correct and complete. All taxes due and owing (whether or not shown on any tax return) have been paid."
- The private equity fund wants to give Buyer the tax rep.

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Unwaivable Conflicts of Interest

- A conflict is unwaivable if:
 - The lawyer cannot reasonably conclude that he or she is able to provide competent and diligent representation to each affected client
 - Representation is prohibited by law
 - Client's interests are "fundamentally antagonistic"
 - Representation involves assertion of a claim by one client against another client in the same litigation or other proceeding

Imputed/Vicarious Conflicts

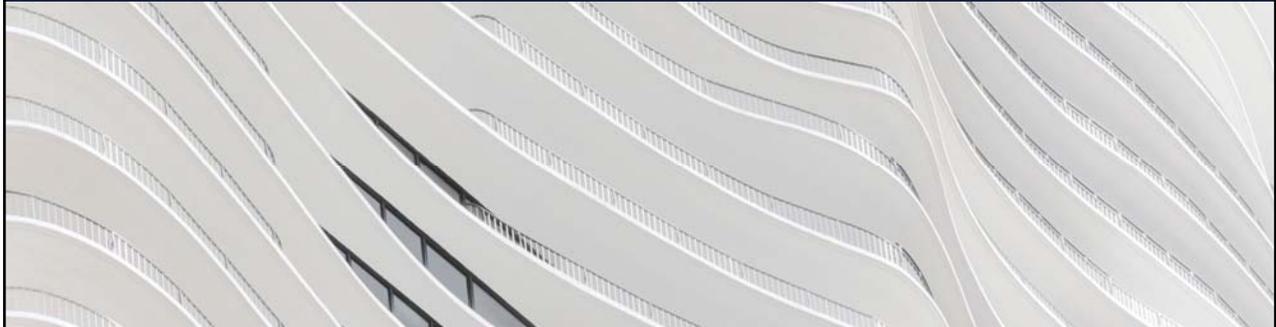
- The conflict of interest of one person in a law firm is generally imputed to everyone in the firm, causing the whole firm to be disqualified
- ABA Model Rule 1.10.



"What conflict of interest?!
I work here in my spare time."

Hypothetical 3:

Joint Representations in Mergers and Acquisitions



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Facts

- You receive a call from a client's COO regarding a potential transaction involving a sale of investor equity, and some cash out for management, and a continuation of key employees.
- The COO advises that management owns 20% of the interests and will rollover half of that.
- The investors have been passive and know nothing about the company.
- The COO advises that the most significant sales contract is up for renewal and may not be renewed.
- Your neighbor, the CFO, told you at last weekend's barbeque, that he made a significant payment to King Abdul's son and was not sure what it was for.

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Concurrent Representation of Organization and Constituent Clients

Rule 1.13

- Lawyer may represent concurrently the organization and its directors, officers, members, shareholders and employees, subject to the conflict of interest rules
- “[O]rganization’s consent to the dual representation... shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders”
- Organization expects attorney to be available for representation adverse to constituent
- Constituent client expects duty of loyalty from attorney

Potentially conflicting Duties

Rule 1.13

- Potentially conflicting duties under ABA Rule 1.13:
 - Attorney *must* “report up” the corporate ladder, when it knows that a constituent has violated or intends to violate the law likely to result in substantial injury to the organization
 - Attorney *may* “report out” to authorities outside the organization if the highest authorities within the organization fail to act on a violation attorney believes reasonably certain to result in substantial injury to the organization

Conflicts of Interest Representing Sell-side:

- Active (employed) shareholders
 - stock price v. employment terms
- Passive investors: stock price only
- Controlling owner:
 - premium for control shares
 - compensation for personal liability for representations and warranties
 - personal liability for indemnification
- Board of Directors dealing with bidders (Del Monte):

Conflicts of Interest – Buy-side

- Joint venture acquirer
- Single purpose entity
- Teaming/ clubbing arrangements
- Unknown limits of authority (foreign deals, parent/ subsidiary, internal disputes on buy-side)

Representing Buy-side Group

- Single counsel for buying group
- Dominance of principal or favored buyer
- Special treatment: information; insight
- Lesson from Del Monte: Understand/communicate limits on bidding conduct

Knowledge of Client's Omission

- An attorney who knows that:
 - A client has not complied with the Internal Revenue Code; or
 - Has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the Internal Revenue Code, must:
 - Advise the client promptly of the noncompliance, error, or omission; and
 - Advise the client of the consequences as provided under the Internal Revenue Code and regulations of such noncompliance.
- Circular 230 § 10.21.

Material Advisors

- Any person who provides “any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and directly or indirectly derives gross income in excess of the threshold amount.”
 - \$50,000 (\$10,000 if listed) if individual
 - \$250,000 (\$50,000 if listed) any other case
- Providing a “tax statement” is generally sufficient. Treas. Reg. § 301.6111-3.

Non-Disclosure Penalty for Material Advisor

- Section 6707 penalty for failure to disclose as a material advisors:
 - Transaction other than listed transactions:
 - \$50,000
 - For listed transactions, penalty is the greater of:
 - \$200,000 or
 - 50% of gross income derived
- Strict liability penalty for listed transactions and no judicial review

When interests diverge

The CEO tells you that he expects to receive a premium for his control shares and a lucrative employment agreement

- What are your responsibilities if the CEO's personal interests are, or could become, directly adverse to the interests of the other shareholders?
- Are you permitted to continue to represent all the selling shareholders?
- What information should you get before proceeding any further in order to decide who you may and may not represent?
- What precautions should you take before communicating directly with any of the other shareholders

Navigation tools

Joint Representation Basics:

- Inherent conflicts always require waiver
- Whether conflict may be waived depends on the circumstances
- May not be waived if parties' interests are fundamentally antagonistic
- May be waived if parties' interest are generally aligned (even if some differences exist)
- Permissible to seek to establish or adjust a relationship between clients on an amicable and mutually advantageous basis

Life gets sticky

- “Default” Outcomes in Undocumented Joint Representations
 - All information related to the matter must be shared with all co-clients
 - If actual conflict develops – must withdraw from all affected co-clients
 - Confidential information disclosed cannot be “recalled” if a conflict arises

Avoiding Default Outcomes in Joint Representations

- Identify sources of possible conflict
- Specify limitations on sharing confidential information
- Describe risks:
 - Divided loyalty
 - Attorney-client privilege
 - May need to withdraw
 - May need to engage separate counsel
- Explain reasonably available alternatives:
 - Separate counsel

Hypothetical 4:

Negotiation Issues



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Facts

- *The associate working on the disclosure schedules for the agreement tells you that the CFO deleted the disclosure about a cease and desist letter received from an inventor asserting that one of the Company's best selling products infringes his patent. The CFO is insisting that because that inventor has not filed a lawsuit, the inventor's assertion of patent infringement does not need to be listed on the schedule. The associate is concerned that, in fact, the matter should be disclosed to the Buyer as a "threatened" material adverse event. Also, in face to face negotiations with the Buyer and Buyer's lawyer, the CEO stated unequivocally that the Company had never been sued or even threatened with a serious lawsuit and that the Company's patents are "unassailable."*



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Who is liable for what?

- Do you have a duty to correct or require the client to correct the misinformation given to the adverse party?
- Are you obligated or permitted to withdraw if the client persists in a course of action that you believe is unethical?
- Could you be liable to the Buyer if the misinformation is not corrected, the deal closes, and an infringement action is brought by the inventor?
- Does the analysis change if you are giving a "no material misrepresentation" opinion?
- Is the associate protected under the Rules of Professional Responsibility if he follows your instruction not to disclose the cease and desist letter?

Ethics in Negotiations

Four directly relevant rules:

- MRPC 1.2(d)
 - MRPC 1.4
 - MRPC 4.1
 - MRPC 8.4(c)(c)
- Not surprisingly, more case law (including disciplinary cases) involving negotiating the settlement of cases than in business transactions

Truth . . . Or *CONSEQUENCES*

- Possible consequences for lawyer whose conduct violates or is alleged to violate these rules:
 - Disciplinary action
 - Judicial sanctions (public scolding---fines)
 - Civil liability for fraud, negligent misrepresentation, or aiding and abetting the client's fraud or breach of fiduciary duty

Ethics in Negotiations

Rule 4.1. Truthfulness in statements to others

- In the course of representing a client a lawyer shall not knowingly:
 - Make false statement of material fact or law to a third person; or
 - Fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6

Ethics in Negotiations:

Rule 4.1 Comments:

- “Misrepresentations can also occur by partially true but misleading statements or omissions that are the equivalent of affirmative false statements.”
- “Under generally accepted conventions in negotiation, certain types of statements ordinarily are not taken as statements of material fact. Estimates of price or value placed on the subject of a transaction and a party’s intentions as to an acceptable settlement of a claim are ordinarily in this category...”

Ethics in Negotiations

- Reliance in fact, or causation, in fact, not technically required to violate 4.1(a) (if reliance would have been reasonable, then whether the counterparty in fact relied is irrelevant)
- "knowingly" defined in Rule 1.0(f) to mean actual knowledge, not bad intention, but case law suggests that reckless disregard can meet the knowledge requirement certain circumstances.
- Under 4.1(b), a lawyer cannot sit idly by when a client dissembles if the client’s conduct amounts to fraud or a criminal act

“Generally acceptable negotiating conventions”

- (ABA Comm. on Ethics & Professional Responsibility, Formal Opinion 06-439)
 - Understating the client's willingness to make concessions
 - Exaggerating strengths and minimizing weaknesses.
 - Estimating price or value.
 - Not disclosing the existence of a principal (except when nondisclosure would constitute fraud).
 - Failing to correct the other party's misunderstanding, based on information from third parties, about the client's finances.

- CAVEAT EMPTOR – puffery is expected

Ethics in Negotiations

- Rule 8.4. Misconduct
 - It is professional misconduct for a lawyer to:
 - engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

And Action

What do you do when a client who wants to push you too close to or over the line?

- Get tough
- Get help
- Report "up the ladder"
- Disaffirm opinion or other documents
- Get going: Withdraw



Preparing for Litigation

- What should you retain?
 - Transactional documents
 - Drafts and final versions of opinions and internal memoranda
 - E-mails or other documents supporting the business purpose
 - Legal research
 - E-mails, notes, or other communications with tax advisors and return preparers
- Maintain electronic documents, communications, and data in native format with metadata.

Work Product & “Litigation Holds”

- Courts have held that a party has a duty to preserve documents as of the date any documents for which the party assesses work product protection.
 - For example, a court may look to whether the documents were maintained consistent with a “litigation hold.”
 - The “litigation hold” must be on all documents concerning the subject matter, not only work product documents.
- Over-labeling documents as “work product” may undercut the protection.



Upjohn Considerations

- When an employee knows that she is not the client, the privilege clearly belongs to the company alone.
 - Problem arises if the employee reasonably believes that she is being represented by the attorney.
 - Courts sometimes find that the privilege applies to both the company and the individual employee.
- Employees should receive Upjohn warning to make clear:
 - Attorney-client privilege over communications between company counsel and employees belongs solely to, and is controlled by, the company.
 - Company may choose to waive this privilege and disclose what the employee says to in-house counsel, to a government agency, or other third party.

Thank you